

TENNESSEE GENERAL ASSEMBLY
FISCAL REVIEW COMMITTEE



FISCAL NOTE

SB 199 – HB 225

March 24, 2015

SUMMARY OF BILL: Redefines “cost of doing business by the retailer” under the Unfair Cigarette Sales Law as fifteen percent of the basic cost of cigarettes to the retailer, rather than eight percent.

ESTIMATED FISCAL IMPACT:

Decrease State Revenue – Net Impact – \$131,300

Increase Local Revenue – \$2,145,800

Assumptions:

- Pursuant to Tenn. Code Ann. § 47-25-302(4), “cost to the retailer” is defined as the “basic cost of cigarettes to the retailer” plus the “cost of doing business by the retailer”.
- “Basic cost of cigarettes to the retailer” is assumed to include state and federal excise taxes, but not state and local sales taxes.
- Pursuant to Tenn. Code Ann. § 47-25-303(a), it is a Class C misdemeanor for any retailer, with intent to injure competitors or destroy substantially or lessen competition, to advertise, offer to sell, or sell at retail, cigarettes at less than cost to the retailer.
- There will not be a sufficient number of Class C misdemeanor prosecutions for state or local government to experience any significant increase in revenue or expenditures.
- Increasing the “cost of doing business by the retailer” will result in a higher price of cigarettes sold at retail.
- Under current law in Tennessee, a retailer may reduce the price of cigarettes based on payments received under tobacco buydown agreements (TBA). In TBAs, a retailer will receive an amount from the cigarette manufacturer; the retailer then must reduce the sales price of the cigarettes without requiring the consumer to show a manufacturer’s coupon, allowing retailers to sell cigarettes at a price below “cost to the retailer”.
- According to the analysis done by the Retail Accountability Program group within the Department of Revenue (DOR), the average buydown payment is assumed to be 10 percent of the price of a 20-pack of cigarettes.
- The average price per pack of 20 cigarettes in Tennessee is estimated to be \$5.00 in FY15-16, which includes state cigarette tax of \$0.62 and a federal excise tax of \$1.01, but does not include state and local sales taxes.
- The average buydown payment is estimated to be \$0.50 (\$5.00 x 10.0%); the cost to the retailer is estimated to be \$5.50 (\$5.00 + \$0.50); the basic cost of cigarettes is estimated

to be \$5.09 (\$5.50 / 108%); and the cost of doing business by the retailer is estimated to be \$0.41 (\$5.50 - \$5.09).

- The average buydown payment is estimated to be 9.1 percent of the cost to the retailer (\$0.50 / \$5.50).
- According to DOR, cigarette tax collections were approximately 246,740,100 in FY13-14. Assuming negative growth of 0.9 percent in FY14-15 and 1.6 percent in FY15-16, cigarette tax collections in FY15-16 are assumed to be approximately \$240,607,128.
- Pursuant to Tenn. Code Ann. § 67-4-1004(a) and Tenn. Code Ann. § 67-4-1004(d)(1), cigarette tax is a \$0.62 tax per pack of 20 cigarettes.
- The total number of 20-pack cigarettes sold in FY15-16 is estimated to be 388,076,013 (\$240,607,128 / \$0.62). This number is assumed to remain constant into perpetuity under current law.
- Under this bill, the basic cost of cigarettes is estimated to be equal to \$5.09 (same as under current law), and the cost of doing business by the retailer will be \$0.76 (\$5.09 x 15.0%). The cost to the retailer is therefore estimated to be \$5.85 (\$5.09 + \$0.76), and the average buydown is estimated to be \$0.53 (\$5.85 x 9.1%).
- Increasing the cost of doing business by the retailer, from eight to fifteen percent of the basic cost of cigarettes to the retailer, is therefore estimated to result in a price increase for cigarettes to an average of \$5.32 per 20-pack (\$5.85 - \$0.53).
- This represents a 6.4 percent increase in the price of cigarettes sold to the consumer per each 20-pack [(\$5.32 - \$5.00) / \$5.00 x 100]. The increase in price of cigarettes will result in a decrease in the consumption of cigarettes.
- Based on various studies, the price elasticity of demand for cigarettes is estimated to be negative 0.35. The 6.4 percent increase in the price of cigarettes is estimated to result in a 2.24 percent decrease in the quantity of cigarettes consumed (6.4% x -0.35).
- The number of 20-pack cigarettes sold as a result of this bill in FY15-16 is estimated to be 379,383,110 [388,076,013 x (100.00% - 2.24%)]. This number is assumed to remain constant into perpetuity.
- The total recurring decrease in state cigarette tax collections in FY15-16 and subsequent years is estimated to be \$5,389,600 [\$240,607,128 - (379,383,110 x \$0.62)].
- The current state sales tax rate is 7.0 percent; the average local option sales tax rate is estimated to be 2.5 percent; the effective rate of apportionment to local government pursuant to the state-shared allocation is estimated to be 3.617 percent.
- The total taxable sales of cigarettes are estimated to increase by \$77,938,080 as a result of this bill [(379,383,110 x \$5.32) - (388,076,013 x \$5.00)].
- The net recurring increase in state sales tax revenue is estimated to be \$5,258,335 [(\$77,938,080 x 7.0%) - (\$77,938,080 x 7.0% x 3.617%)].
- The total recurring increase in local sales tax revenue is estimated to be \$2,145,783 [(\$77,938,080 x 2.5%) + (\$77,938,080 x 7.0% x 3.617%)].
- The net recurring decrease in state revenue beginning in FY15-16 is estimated to be \$131,265 (\$5,389,600 - \$5,258,335).

IMPACT TO COMMERCE:

Increase Business Revenue - \$128,895,600

Assumptions:

- Based on the assumptions above, the “cost of doing business by the retailer” will increase by \$0.35, from \$0.41 to \$0.76 per 20-pack of cigarettes, as a result of this bill.
- The number of 20-pack cigarettes sold is estimated to be 388,076,013 under current law and 378,956,227 under this bill.
- Business revenue collected from the “cost of doing business by the retailer” portion is estimated to be \$159,111,165 ($\$0.41 \times 388,076,013$) under current law, and \$288,006,733 ($\$0.76 \times 378,956,227$) under this bill. All of this revenue is assumed to be retained by the cigarette retailers.
- As a result, it is estimated that business revenue for such retailers will increase by \$128,895,568 per year as a result of this bill.

CERTIFICATION:

The information contained herein is true and correct to the best of my knowledge.



Jeffrey L. Spalding, Executive Director

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